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Report Highlights: Hungarian consumers are becoming more segmented and the retail food sector continues to consolidate. Tourism is also becoming more important and hotels and restaurants are demanding higher quality foods and services. However, complicated import rules (such as product registration) and high import duties can make it difficult to compete with locally produced products.

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SUMMARY

After a period of decline, Hungary's production and consumption of processed foods is now on the rise. The economic situation continues to improve as the Hungarian government prepares for EU accession sometime in 2004. The Hungarian food distribution system has changed drastically in the past five years. There has been an infusion of foreign capital into the retail food sector resulting in the opening of state-of-the-art hypermarkets. These provide 'wide channels' of distribution for new products. Hungarian consumers are becoming more and more quality conscious and opportunities exist for high quality U.S. foods and beverages. Tourism is growing and hotels and restaurants are demanding higher quality foods and services. U.S. exporters are well positioned to take advantage of this growing market segment. However, complicated import rules (such as product registration) and high import duties can make it difficult to compete with locally produced products and the EU competition.

I. MARKET OVERVIEW

Overall Business Climate

Hungary is a middle income country with a well developed and export-oriented food processing industry. Hungary's GDP growth is forecast to be 3.6 percent for 2002 and GDP is now back above the 1989 real GDP level. Hungary is expected to show strong growth again in 2003. High export growth and large privatization receipts in the last three years have allowed Hungary to rapidly reduce its foreign debt load. Hungary is expected to continue its careful handling of its now manageable debt burden in order to maintain a favorable credit rating and borrowing terms. The inflation rate continued to fall in 2001 (9.2%) and the 12-month inflation rate to May of 2002 was 5.9 percent. With a stock of about \$25.8 billion in Foreign Direct Investment (FDI) in December, 2001, Hungary has been the leading destination for FDI in Central and Eastern Europe (including the former Soviet Union). Of this, over \$8.6 billion has come from U.S. companies. The largest U.S. investors include Ameritech, GE, General Motors, U.S. West, Coca-Cola, Ford, IBM, PepsiCo, McDonalds, Pioneer Brand-Seed, and Monsanto. The large American corporate presence is reflected in the local chapter of the American Chamber of Commerce, which has over 400 members. Products at least partially produced by foreign-owned companies account for almost 75 percent of Hungary's exports.

The agri-food sector has a slowly declining but fundamental role in the national economy and in the trade balance. Agricultural trade accounted for \$ 2.29 billion in exports and \$980 million in imports in 2001. More than sixty percent of Hungary's agri-food exports went to the OECD countries; the share going to EU countries was 45 percent. Imports of bulk agricultural products and intermediary goods (such as protein meals, coffee, cocoa and spices, meat, livestock genetics, fruit and nuts) make up 80 percent of total agricultural imports. Processed foods and beverages account for about 20 percent of the total, and these are imported mainly from the countries of the EU.

The agricultural sector has many traditional ties to the United States, especially in the area of genetics. Some consumer-oriented products also come from the United States. Purchases of U.S. agricultural and food items accounted for \$39 million in 2001. Hungarian sales to the United States were \$24 million in the same period.

Consumer Food Market

Food consumption dropped considerably after the political and economic changes of the late 1980s. The main reasons for the decline were a decline in real income and high inflation. However, consumption began to rebound in 1997/1998 as macroeconomic conditions improved and inflation cooled.

The gap between the rich and poor in Hungary is widening and the less fortunate tend not to shop at large commercial retailers. Also, in response to high taxes, the black market has taken on an increasing role in supplying food to lower income families and subsistence farming and unregistered farm food sales are on the rise. At the same time, disposable income for the top strata of society has expanded rapidly and these consumers are adopting consumption patterns similar those found in wealthy western European countries.

The last few years have seen interesting changes in consumer preferences. For example, pork consumption has decreased from 39 kg in 1990 to 28.5 kg currently but consumption of cheaper meat cuts and low priced frankfurters has increased. Similarly, demand for poultry has increased in recent years and currently exceeds pork. Turkey and frozen oven- ready poultry products have seen the most growth.

Demand for fish and seafood is low in (landlocked) Hungary and stands at 3kg per capita annually. Demand for frozen fish, particularly breaded products and more expensive restaurant cuts, is on the rise.

Although total consumption of milk products declined in recent years, sales of yogurt and innovative convenience products have reversed this trend and consumption now stands at 163.7 kg per capita annually.

Cereal consumption has dropped in recent years except for rice, where a widening array of brands and products has stimulated consumer interest.

There has been an increase in the consumption of fresh and preserved vegetables, although sales of these items appear to be highly price sensitive. Given current consumption trends, canned products will probably gradually lose market share to frozen foods in the coming year.

At present, there is a small but growing market for health foods. The emerging Hungarian middle-class is adopting Western attitudes towards health and well-being, including those towards food. This trend is particularly evident in the sale and marketing of breakfast cereals and snacks. Natural products such as granola bars, dried fruits and fruit mixtures, and soya and wheat-based meat substitutes are also increasingly popular. Demand for vitamin enhanced products as well as those for diabetics (sugar free chocolate bars, light soft drinks, etc.) is growing.

Currently, food and beverages account for about 25 percent of the household expenditures. The percentage of income spent on food has been decreasing and is trending toward Western levels. Hungary's population (currently about 10 million) is gradually decreasing and the population is aging.

Because of this, there is growing demand for high value specialty products, convenience foods, and petfood. According to a 2000 survey, food consumption outside the home accounts for 7.2 percent of total food expenditures.

Ninety percent of Hungarian households have a refrigerator with a freezer compartment. However, because freezing capacity in an average household is still limited, the unit size of retail frozen food packages are smaller than in the United States. According to trade estimates, 37 of every hundred households has a microwave oven. In cities this figure is much higher and increasing rapidly.

Advantages and challenges faced by U.S. food exporters in Hungary

Advantages	Challenges
After a period of decline there is room to increase consumption	Domestic food processing is very competitive
Western consumption patterns are emerging	Strong European competition
There is growth potential in the development of retail sector, especially in suburban and rural areas	Slow increase of real incomes
There are unexplored commodity areas	Bureaucratic import administration (mandatory product registration)
Consumers still find imported products novel and interesting and associate imports with high quality goods	Food safety issues (Hormone beef, GMO)
Domestic industry needs certain ingredients	Many traders are inexperienced in doing business with overseas companies
Purchases by tourists and transit shoppers are large and growing	High transport costs
High number of experienced, multinational retailers	Relatively small delivery volumes
Innovative products and packaging are appreciated	Hungarian consumers are unfamiliar with the value of many U.S. products

Importers are open to new products and technologies and have been willing to participate in U.S. sponsored events (e.g. the Cochran Fellowship Program and visits to trade U.S. food shows)	Importers have difficult time accessing reasonable local finance terms
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II. EXPORTER BUSINESS TIPS

Local Business Customs

The food and beverage wholesale trade is more concentrated than the retail sector. Eleven ‘purchasing partnerships’, run by retailers, handle about 70 percent of total turnover. These purchasing companies are able to influence the price of domestic and imported foods and charge different fees to domestic and foreign suppliers. Fees include a “listing fee” to introduce a new product into the retailer’s inventory, slotting fees to keep a product on the store shelf, and “marketing and shop network development contributions.” Care must be taken to guard against excessive fees.

Retailers, including the multinational chains, mainly import through domestic foreign trading companies and wholesalers. U.S. traders interested in selling in Hungary should offer their products to the ‘purchasing partnerships’ that serve the big retailers, to the nation-wide network importer/distributors, or to “independent” importers. U.S. companies may even consider establishing their own import company to handle the distribution of their product.

The Hungarian wholesale market is also very price sensitive and Hungarian importers will expect American traders to bring samples and quote prices in the early stages of negotiation.

General consumer tastes and preferences

Consumption patterns appear to be dependent on income rather than price. Major factors in upper income purchasing decisions are quality, packaging, and brand recognition. To date, foreign suppliers seem to have been better able to capture this market segment than domestic suppliers. Because of income stratification, demand for cheap foodstuffs and expensive luxury items has increased while sales of medium priced products has declined.

New products are appearing in many categories and packaging designs are revised frequently. One negative aspect of this trend is that some popular and affordable products have disappeared and environmentally friendly reusable glass bottles have been replaced by plastic containers.

In the Hungarian food market, brands have secondary importance. Consumers do not make a distinction between brand name, company name and product name. Brand recognition and brand loyalty have a different meaning for the average Hungarian customer than they do in more mature western markets. Sellers cannot rely on brand power for sales and price premiums to the same extent as in other European countries. Many consumers mistrust new products, names and packages, especially if their appearance comes with a price increase. There is also a small movement against

branded, well-advertised, "foreign" products. Conversely, Hungarian customers buy some branded products primarily for prestige (e.g., high-end U.S. bourbon or whisky).

Food standards and regulations

All food products, excluding fresh products, must be registered and approved by the Hungarian food testing institute - OETI (see references at the last chapter of the report). Testing must be completed before the product is allowed on the market. Registration costs approximately HUF 120,000 per product (about \$560). If the product is in compliance with Hungarian food regulations, it then receives a number (so called "OETI number") under which it can be marketed for a three-year time period. After this period has expired, the product must be retested and issued a new number. The OETI number is always indicated on the product label.

Labeling

Labeling must be in Hungarian. In instances where retail packages are imported with labels written in English, the government requires that Hungarian-language label stickers be added. Labels should include the following information:

- Name of product
- Ingredients
- Shelf life
- Name and address of importer or distributor
- OETI number

Tariffs and tariff rate quotas (TRQs)

The Hungarian WTO tariff schedule is available at

http://www.fas.usda.gov/scripts/wtopdf/wtopdf_frm.asp. Hungary's tariff system is based on the international HS system and the tariff schedule has the following structure: the first column (I.) is the so-called 'GSP' column for tariffs on imports from developing countries, the second column (II.) contains WTO/MFN tariffs, and the third column (III.) contains the preferential tariffs based on free trade agreements with the EU, EFTA, CEFTA (Poland, Czech Republic, Slovakia, Slovenia, Romania, Bulgaria, Estonia), Turkey, and Israel. Products from the United States enter Hungary at the MFN rate, or in some instances, at a lower applied rate.

In addition to tariffs, Hungary maintains tariff rate quotas (TRQs) on a wide range of agricultural products (over 150 separate tariff lines). In some instances, a TRQ will allow a product to enter Hungary at a lower tariff rate. However, TRQs are allocated both on a country specific basis and on a Most Favored Nation (MFN) basis and the administration of specific TRQs can be very complicated. It is recommended that U.S. exporters gather information about the availability of TRQs when evaluating business opportunities. The local FAS office maintains an up to date listing of TRQs and can assist in this regard (see the FAS point of contact under Section V of this report).

Taxes

Value added taxes (VAT - also called the 'general turnover tax' in Hungary) are also charged. The VAT is essentially a tax on consumption and the normal rate is 25 percent, with a reduced rate of 12 percent applying to most food and agricultural products. In addition to the VAT, a consumption tax is

levied on certain goods (coffee, some kinds of wine, jewelry etc.). Excise taxes are also levied on alcohol and tobacco products. Imports are subject to VAT, with the taxable base calculated as the sum of the customs value, plus customs duties, fees and consumption tax.

III. MARKET SECTOR STRUCTURE AND TRENDS

Market opportunities in:

a. Food retail sector

Food retail sales were \$5.37 billion in 2000 and it grew to \$6.16 billion in 2001 (a 4 percent increase at comparable prices).

Concentration in the grocery trade has increased over the last few years. By 2001, more than 50 percent of the turnover was attributable to just six percent of companies and international retail chains controlled 44 percent of the market in 2000. The total number of food dominated shops decreased (from 37,154 in 2000 to 36,912 in 2001). The average size and the number of new hypermarkets is on the rise, while the number of small (under 200 sq. meter) shops dropped the most.

Size of Shops	Turnover 1998	
	Total (HUF bn)	%
Total	1,290	100
Over 1,000 sqm	330	25.6
401-1,000 sqm	350	27.1
201-400 sqm	170	13.2
101-200 sqm	210	16.3
40-100 sqm	140	10.9
Under 40 sqm	70	5.4

Hypermarkets bigger than 10,000 square meters include Cora, Tesco and Auchan, while cash and carry shops (5,000-10,000 square meters) include Metro, Interfruct C+C and Alfa. Supermarket chains such as Billa, Spar, Kaisers, and CBA are well known in the capital area and in bigger cities. Their size is typically 1,000-3,500 square meters. Discount food stores (401-1,000 square meters) are the backbone of the everyday food shopping (Profi, Penny-Market, Plus, Jee)

A traditional consumer cooperative chain, COOP, has still the most shops in the 200-400 and the 400-1,000 square meters size categories. But the 40-400 square meters size shops have been the biggest losers in the concentration process - their share of the total turnover has decreased from 22 percent to 13.4 percent during the last four years.

While the number of the small convenience shops is relatively stable, turnover is high. About one third of them close annually and are replaced by newly opened shops.

Changes to Hungary's import regime as a result of the 1995 WTO Uruguay Round Agreement have spurred consumer imports. One response to increased import competition has been an increase in the quality and selection of products provided by domestic food producers. Multinational food companies investing in privatized food manufactures have also helped to increase the quality and appearance of domestic products. In 2000, about 9.1 percent of the food and beverages retail sales were from imports. The biggest import items are tropical and out season fruit, roasted coffee, canned fruits and vegetable, fruit juice, beer and tobacco products.

Specialty shops, many of them at recently opened shopping malls, may provide good business opportunities for imported foodstuffs. Nearly thirty large shopping centers have been built in Budapest and other cities in Hungary in the last three years. Supermarkets (typically 2,000-3,500 square meters in size) are an important part of each new shopping mall.

Gift shops and sweets shops also sell a variety of foreign wine and spirits, fancy dry fruits and nuts, sweets. Gift baskets of food are also commonly for sale in bigger food stores, particularly around Christmas and Easter. Fancy food and spices shops, specialty beverages shops, pet shops etc. are also important distribution channels of imported commodities.

Most of the more than 900 gas stations in Hungary are also convenience stores. The size of these convenience shops varies from 200-1,300 square feet. According to a recent survey, 35-45 percent of shop sales are food and beverage items. Most of Hungary's ten major gas station companies run the shops themselves. Shell Hungary, however, has for years run its "Select" stores under a franchise partnership with CBA, a major domestic grocery chain.

There are about 150 companies in Hungary that sell their products over the Internet. According to a May 2002 GKI - Westel - Sun Hungary survey, Internet sales revenues were about \$18 million in 2000. This is a 500 percent increase over 1999. The most common goods sold are books, music, electronics and gifts. There are several grocery companies in bigger cities running e-commerce websites for home delivery of food and grocery items. The majority of non-food B2C companies use the Hungarian Postal Service to deliver their goods; food retailers use their contractors or have their own car fleet. In most cases, payment is collected upon delivery.

b. Hotel-Restaurant-Food Service

Catering sales were \$1.37 billion in 2001, a mere 0.4 percent growth over the previous year. However, the biggest growth rate within the HRI sector is in fast-food. Several well known companies have franchise networks in Hungary, including McDonalds, Pizza Hut, Kentucky Fried Chicken, Wendy's and Mr Sandwich.

Foreign and "theme" restaurants offering ethnic food and beverages also appear to be growing faster than the restaurant sector in general. These restaurants use and sell imported ingredients and niche products, making them a good place to advertise new products and to educate consumers about new foods.

Upper-tier hotels can also be good partners for U.S. exporters. Not only as hosts for promotional events but also as buyers of premium ingredients and beverages. Most hotel shops sell American products and hotel and catering trade opportunities are under-utilized. Hotels and restaurants mainly buy imported products from local distributors but their managers and chefs are good sources of information about customer preferences and quality and price expectations.

c. The Food Processing sector

Hungary's food processing sector is the most modern in Eastern Europe, and its export revenues are vital to the country's trade balance. Western companies have invested in privatized companies active in distilling, sugar production, soft drinks, vegetable oil processing, confectionary, petfood, snacks, and tobacco. These processors have received a good deal of foreign investment, have integrated themselves into a Western-style market system, and are becoming more concentrated in their ownership structure. In other industries, privatization took place more slowly and investors have typically established small-to mid-sized joint ventures with a domestically-owned majority interest. Examples of this model include investment in the milling, baking, pasta, and poultry industries.

Within most parts of the food processing sector, the increase in the number of companies and new production facilities, in tandem with the decline of domestic consumption, initially led to excess production capacity (sometimes over 30 percent above demand). Overcapacity in turn increased the pressure to export. In 2001, 22 percent of food industry output was exported but the export orientation is much higher for individual sub-sectors such as canning, meat, poultry, dairy industry. Products at least partially produced by foreign-owned companies account for almost two thirds of Hungary's exports.

The total food /beverages sector production is 120 % of domestic demand, indicating a strong export orientation. The following table indicates that the share of imports in the supply of processed food (import penetration) is relative low. Imports are significant for sweets, confectionary and dairy products (need for a wide variety products in these sectors), and fruits/vegetable (need for out season products).

Food Processing Industry Sub-Sector	Export Orientation	Import Penetration
Meat Industry	33.3 %	5.4 %
Dairy	15.3 %	6.2 %
Poultry Processing	42.9 %	0.9 %
Fruit and Vegetable Processing	52.0 %	12.4 %
Brewing	0.7 %	3.0 %
Soft Drinks	8.2 %	2.5 %

Tobacco Industry	Negligible	2.0 %
Sweets and Confectionary	17.2 %	22.8 %
Wine	62.0 %	2.7 %
Feed Milling	23 %	52.0 %
Flour Milling	13.5 %	1.5 %

For many sub-sectors, the consumer oriented product imports are not high, but raw material imports may be considerable. Soybean and fish meal import (Feed milling), almonds and raisins import (Sweets and Confectionary), pork and tobacco all fall into this category.

The number of food processing firms was 8,361 in 1999 but 90 percent of these processors employ less than 11 people. Bigger companies, employing more than 300, account for 67 percent of total sector output.

The food processing industry purchases most of its raw materials from domestic sources, but imports of out season or unavailable agricultural ingredients, non-food additives, and packaging materials and technologies, are vital.

Export sales opportunities for U.S. suppliers have occasionally occurred in recent years because of temporary shortages on the domestic market (meat) or the limited availability of a given commodity or quality grade in Hungary (fruit juice concentrate, rice, tobacco, peanuts, fish, raisins, tree nuts, dried fruit etc.)

IV. BEST HIGH-VALUE PRODUCT PROSPECTS

1. Raisins
2. Dried Fruit
3. Almonds
5. Peanuts
6. Rice
7. Meat (Pork and Beef)
8. Seafood
9. Distilled Liquors
10. Wine
11. Spices & Condiments
12. Pet Food
13. Fruit Juice Concentrates
14. Instant Food
15. Misc. Grocery Items (Snacks, Peanut Butter etc.)

V. KEY CONTACTS AND FURTHER INFORMATION

Ministry of Agriculture and Regional Development

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Hungary

TABLE A: KEY TRADE & DEMOGRAPHIC INFORMATION	YEAR	VALUE
Agricultural Imports From All Countries (\$Mil)/U.S. Market Share(%)	2001	1,152 / 4%
Consumer Food Imports From All Countries (\$Mil)/U.S. Market Share(%)	2001	560/ 3%
Edible Fishery Imports From All Countries (\$Mil)/U.S. Market Share(%)	2001	27 / 1%
Total Population (Millions)/Annual Growth Rate (%)	2001	10 / -0.4%
Urban Population (Millions)/Annual Growth Rate (%)	2001	6.4 / -.2%
Number of Major Metropolitan Areas	2001	1
Size of the Middle Class (Millions)/Growth Rate (%)	n/a	n/a
Per Capita Gross Domestic Product (U.S. Dollars)	2000	\$5,177
Unemployment Rate (%)	2000	6.4%
Per Capita Food Expenditures (incl. beverages/tobacco)(U.S. Dollars)	2000	\$482
Percent of Female Population Employed	2000	45.8%
Exchange Rate (US\$1 = HUF)	9/02	247

Table B Consumer Food and Edible Fishery Product Imports

Hungary Imports (In Millions of Dollars)	Imports from the World			Imports from the U.S.			U.S Market Share		
	1999	2000	2001	1999	2000	2001	1999	2000	2001
CONSUMER-ORIENTED AGRICULTURAL TO	434	504	560	11	11	14	3	2	3
Snack Foods (Excl. Nuts)	61	58	73	1	1	1	0	0	0
Breakfast Cereals & Pancake Mix	5	6	7	1	1	1	7	4	3
Red Meats, Fresh/Chilled/Frozen	17	43	55	1	1	1	0	0	0
Red Meats, Prepared/Preserved	1	2	3	0	0	1	0	0	3
Poultry Meat	1	6	12	1	0	1	11	0	2
Dairy Products (Excl. Cheese)	23	30	33	0	1	1	0	0	0
Cheese	15	22	26	0	0	0	0	0	0
Eggs & Products	3	5	11	1	1	1	33	20	7
Fresh Fruit	43	40	42	1	1	1	0	0	0
Fresh Vegetables	12	15	17	1	1	0	0	0	0
Processed Fruit & Vegetables	44	49	56	3	4	5	7	8	9
Fruit & Vegetable Juices	19	31	16	1	1	1	1	1	2
Tree Nuts	13	12	13	2	1	2	14	11	13
Wine & Beer	11	10	10	1	1	1	0	1	0
Nursery Products & Cut Flowers	23	25	27	1	1	1	0	0	0
Pet Foods (Dog & Cat Food)	15	16	16	1	1	1	4	1	2
Other Consumer-Oriented Products	128	135	143	4	4	5	3	3	4
FISH & SEAFOOD PRODUCTS	22	23	27	1	1	1	1	1	0
Salmon	1	1	1	0	1	0	0	1	0
Surimi	1	1	1	0	1	0	0	1	0
Crustaceans	1	1	1	1	0	0	1	0	0
Groundfish & Flatfish	8	8	10	1	1	1	2	1	1
Molluscs	1	1	1	1	1	1	0	0	1
Other Fishery Products	10	11	13	1	1	1	0	0	0
AGRICULTURAL PRODUCTS TOTAL	1,022	1,064	1,152	46	39	50	4	4	4
AGRICULTURAL, FISH & FORESTRY TOTAL	1,286	1,365	1,468	49	44	53	4	3	4

Source: FAS' Global Agricultural Trade System using data from the United Nations Statistical Office

Note: Many products U.S. products are transhipped from European suppliers and do not appear on official statistics.